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Fire Insurance:

Its importance;

Its relation to the community;

It is not a trust;

Why an individual cannot insure himself;

Why the State cannot insure its citizens;

Why valued policy laws are injurious to the community;

Why adequate rates are in the interest of the people;

Why associations of insurance companies reducing the expense of inspecting buildings and rating them are in the interest of the people;

Why corporations are beneficial to the people.

FIRE INSURANCE:

ITS IMPORTANCE ;

ITS RELATION TO THE COMMUNITY ;

IT IS NOT A TRUST ;

WHY AN INDIVIDUAL CANNOT INSURE HIMSELF ;

WHY THE STATE CANNOT INSURE ITS CITIZENS ;

WHY VALUED POLICY LAWS ARE INJURIOUS TO
THE COMMUNITY ;

WHY ADEQUATE RATES ARE IN THE INTEREST
OF THE PEOPLE.

WHY ASSOCIATIONS OF INSURANCE COMPANIES
REDUCING THE EXPENSE OF INSPECTING
BUILDINGS AND RATING THEM ARE IN THE
INTEREST OF THE PEOPLE ;

WHY CORPORATIONS ARE BENEFICIAL TO THE
PEOPLE.

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EXPLANATORY.

At the September, 1899, meeting of the Executive Committee of the National Board of Fire Underwriters, a committee was appointed to prepare an explanation of the principles and methods of the business of fire insurance and its importance and relation to the community at large, in the hope and belief that a better understanding of the subject would relieve the business of at least some of the opposition with which it has to contend on the part of legislatures and property-owners. The following pages have been prepared after careful canvass among experienced underwriters for suggestions and criticism. The Committee have endeavored to present a fully prepared argument and explanation of the business for the use of underwriters called upon at short notice to explain to a legislature the proper method of taxing insurance companies; the objections to valued policy laws and laws prohibiting the co-operation of companies for improving the business; and the reduction of its losses and expenses; which laudable ends can only be secured by co-operation. They have endeavored to explain that co-operation, which would reduce the expense of inspecting buildings and supervising them, is directly in the interest of property-owners and of the country at large, whose enormous fire waste, year by year, can only be reduced by calling the attention of property-owners to faults of management, improper construction, etc., etc., which result in the destruction of their buildings and sometimes in the destruction of entire cities. These inspections can be performed for all of the companies insuring a property as cheaply as for any one of them.

NEW YORK, Oct. 1, 1899.



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THE RELATION OF FIRE INSURANCE TO THE COMMUNITY.

IS FIRE INSURANCE A TRUST?

As a proper understanding of this question involves more or less technical or expert knowledge, possessed only by those engaged in the business, it may be well, for the benefit of those of other callings, briefly to explain those fundamental principles of underwriting which are indispensable to a correct conclusion from a community standpoint.

It is perhaps unnecessary to explain that the "Premium" is the price paid an insurance company for assuming the risk of fire; that the "Rate" is the charge per \$100 of insurance, fixed according to the construction of the building, its occupation, environment and facilities, public and private, for extinguishing fires; and that the "Policy" is the contract, a unilateral one, written and issued by the insurance company to the property-owner.

It is not generally understood that a policy of insurance is not an agreement to pay a stipulated sum by way of liquidated damages in the event of the destruction by fire of the subject insured, which would be a "wager" and contrary to public policy, but is simply an undertaking on the part of the insurance company to indemnify the owner to the extent of his loss in actual value damaged or destroyed; the amount of insurance named in the policy and paid for at the rate of premium being a limit of claim and not a measure of it.

The rate of premium or price charged by the company is not based upon the expectation of burning of a particular risk insured, but upon the number of risks of like kind which would be burned or damaged out of say a thousand in any single year. At a rate of one per cent., for illustration, a thousand risks, each insured for \$1,000, would yield \$10,000 in premium. If ten risks out of the thousand should burn in a year the entire amount of premium would be required to pay the loss. It is evident that a smaller number than ten must burn, or a higher rate than one per cent. must be obtained, to provide for expenses as well as losses.

The proper rates of premium for the various kinds of property—dwellings, churches, schools, stores and manufactories—are based, therefore, upon the observed number of risks and amount of loss in each class which burn out of a thousand of like kind in a single year. If the business of fire insurance is conducted on proper lines the element of luck or chance does not enter into it. While nothing could be more uncertain than the probabilities of escape from loss by a single risk, nothing can be more certain than that the average loss in thousands of risks of the same hazard, environment and conditions will be the same year by year; but to ascertain this average percentage of loss a comparison of the experience of all, or nearly all, of the companies engaged in the business is necessary, certainly in the case of most hazards, for the obvious reason that no one company would have enough of most classes on its books, outside of such large classes as dwelling houses, farm buildings, etc.—especially in single States—to indicate the expectation of what might be termed the fire mortality, or the loss on any one class.

This consideration indicates the mistake of confining the business of an insurance company to a single city or limited territory, as it would deprive the company of a sufficient average, and any legislation, therefore, prohibiting the conference of companies for comparing their experience in other States, in order to ascertain an adequate rate, would be subversive of the principles of insurance. It might happen that a single company in a single State or, for that matter, a single company throughout the United States, would show a loss on a certain class of hazards, while the experience of all companies put together would show a fair profit at the rate obtained. The co-operation of insurance companies to ascertain correct rates is, therefore, necessary.

Take the risk of whiskey in brick warehouses, for example. A large company having an exceptionally broad general experience, incurred losses on this particular class during a five-year period in the two States of Kentucky and Tennessee in excess of the premiums taken. Such an experience would seem to indicate that the rate obtained of 90 cents per \$100 was too low, whereas the experience of all the companies doing business in the two States named proved that it was sufficiently high, and the rate

was not raised. This same company during the same period in another section of the country—the Middle States—lost nothing on the same class; an experience which, taken alone, would seem to indicate that the rate obtained was for that locality too high, which was not a fact, however, for the experience of all the companies doing business in the territory showed the rate had been properly fixed and that the experience of this single company was simply exceptionally unfortunate in the one territory and exceptionally profitable in the other. All of which clearly indicates how broad must be the experience on which rating tables are based, not merely for the protection of the insurance companies themselves, but for the protection of the public; and how unwise would be legislation prohibiting the conference of companies for comparing their experience to ascertain and secure equitable rates. Insurance companies should not confine their operations to single cities, not alone because their experience tables will not indicate proper rates of premium, but because in order to get sufficient income they would be tempted to assume larger liabilities at the risk of fire than they could discharge in case of sweeping conflagrations like those of Boston and Chicago, by which nearly one hundred companies failed. The local companies of those two cities did not pay a sum equal to simple interest for a single year on the amount of their claims, and their loss claimants had to wait a longer time for this small proportion of their money.

WHY CANNOT AN INDIVIDUAL INSURE HIMSELF OR CARRY HIS OWN RISK?

The argument so frequently made by some property-owners that they have paid insurance for a long term of years without collecting a single loss and should, therefore, have a lower rate, is based upon ignorance of the principles of fire insurance; their contention overlooks the fact that at a rate of 1 per cent. it would take nearly forty-one years compounding the interest at 4 per cent., for a sum of money equal to the premium paid at the beginning of each year to equal the amount insured and therefore, enough to pay a total loss; and this without any

allowance for the expense of conducting the business. Anyone can verify this computation for himself. One dollar collected and invested at the beginning of each year, the interest being compounded at 4 per cent., would amount to \$98.82 at the end of forty years. Four per cent., it is unnecessary to add, is a larger return of interest than insurance companies receive under existing and proper legislative limitation as to investments in safe securities.

The most reckless gambler would not give such odds as one hundred to one against the happening of a single fire within a period of forty years, knowing the hundreds of ways in which a fire could occur; and the property-owner who carries his own risk is, therefore, taking a chance of losing his all upon odds which a professional gambler would ridicule. In fact, the only individual who can afford to go without insurance and take the risk of the burning of his own property is one—if there be one—who has hundreds of different pieces of property, all of the same average value and so separated that no two could be destroyed by the happening of a single fire. If he is not so situated, fire insurance is necessary for his protection. His commercial credit will be found to depend upon it; no one can afford to sell him goods on time or lend him money if he is not insured, for his ability to pay would be destroyed by a fire and his creditors would find that they had practically been insuring him themselves, without the compensation that a prudent insurance company, engaged in the business of taking risks, would have charged. The cost of insuring a frame building in a frame neighborhood in localities beyond the protection of fire departments might be 5 per cent. or more; and the merchant who sells goods to a customer who does not insure would practically be insuring him for nothing at a cost equal to or more than the profit on his sales.

It is this ignorance of the danger of fire, due to the limited experience of a single risk, that leads to mistaken views of Insurance, which involves for its successful conduct as a business sufficient knowledge of all others to estimate properly the fire hazards of their methods. The owner of a flour mill may never have suffered from fire; he would

necessarily be ignorant as to the causes of fires which have occurred in other mills than his own; but the underwriter, who has had to pay for losses in thousands of properties, is not and cannot afford to be ignorant. It is best for the individual to entrust this branch of his worldly affairs to those who understand it, for the same reason that he entrusts the erection of his building to the mason, carpenter and architect.

CANNOT THE STATE SAFELY CONDUCT THE BUSINESS OF INSURANCE FOR ITS CITIZENS?

Theoretically, yes; but practically nothing would be gained, the chances being largely in favor of a higher cost to citizens and poorer management than would result from the conduct of the business by men engaged in it for a livelihood. The State would need the same expert and clerical labor as an insurance company. It would require inspectors, adjusters, book-keepers, and men qualified for the various branches of the business to the same extent that insurance companies would, but with this difference, that they would too often be appointed for political reasons, rather than because of personal qualifications for the duties to be discharged. There is no more reason why the State should conduct the business of insurance than why it should conduct any other business—that of groceries, dry goods or manufacturing. It is safe to say that in the distribution of labor in a community the community will regulate itself. *No single calling can secure an undue amount of profit without attracting to it enough competitors from other callings to keep prices at a proper level.*

What would have been the burden of the citizens at large of the two states of Illinois and Massachusetts if they had been called upon to pay the losses of their two cities of Chicago and Boston in the years 1871 and 1872? Fortunately for them the citizens of the entire country, almost of the entire world, contributed, through the fire insurance companies, to pay the millions that were required for the purpose.

PROFITS OF THE INSURANCE BUSINESS.

The rates obtained by insurance companies are sufficient simply to insure the payment of losses and a moderate profit on the capital. *No combination, in any business, can possibly be injurious to the public which furnishes to that public the article produced at the lowest price consistent with fair return upon the capital invested and proper remuneration for the labor employed.*

Insurance
Profits
Small.

The statistics of all the companies engaged in the business, through a long series of years, show that *the profits of the business of insurance have been less than three per cent. of the premiums collected; dividends paid to stockholders in excess of that per cent. have been received from interest returns on capital and invested surplus*—an increment which would have come to the owners of such assets without placing them at the risk of fire.

The laws of the various States require detailed statements of insurance companies, showing every item of their income and every item of expense; the amount of their premiums received and of losses paid. There is, in fact, no other business

Publication of
Insurance
Accounts and
Business
Details.

whose methods, income, expenses, losses and profits are thus exploited for the information of the public. There are no trade secrets in fire insurance. If the business is conducted at unnecessary expense or with undue profit, the result will be known and invite new companies to enter into competition, and it is impossible for any single company, or any number of insurance companies, to maintain any form of monopoly.

It is doubtful if any mercantile or manufacturing business could live if obliged thus to publish at the end of each year, for the information of competitors and customers, the fullest details of its transactions. Indeed, if the laws now in force for the regulation of the business of fire insurance—the compulsory publication of accounts, etc.—were applied to other branches of business, manufacturing and mercantile, the present war against so-called “trusts” and combinations in those branches would be unnecessary.

What, then, has been the protection of the business of fire insurance that it has been able to survive this public exhibit of all the details of its methods and its exact profits? It has been the fact that the profit of the business has been so low as not to encourage the organization of companies. Does not the simple fact that the public shows its unwillingness to invest in insurance stocks on other than a 6 per cent. basis, indicate what the published figures of the business clearly prove, that there is no abnormal profit in it and that investors recognize the element of risk and have an apprehension of the facts, or surely the stocks would find purchasers on a better basis than 6 per cent.? The stocks of well-managed railroads are to-day selling on a 4 per cent. basis.

In connection with this should be taken into consideration that new companies can be easily organized. They have to acquire no "right of way," no franchise or the construction of a valuable building plant; there are no patent rights or copyrights involved; the necessary capital—and the law does not require a large one,—with a little office furniture and stationery, is all that is needed to launch a new fire insurance company. Surely the written and unwritten law of trade and the rules of competition can be relied upon to regulate the profits of such a business without legislative interference.

ADEQUATE RATES ARE IN THE INTEREST OF THE PUBLIC.

As already stated, the ascertainment of the average percentage of loss, to be correct, involves comparison by insurance companies of their experience, in the interest of the property owner, as well as in the interest of the insurance companies; for an inaccurate estimate would be as likely to be too high as too low. If it is too high, the property owner will be called upon to pay an excessive rate of premium; if it is too low, the company will lose money; and as capital is simply an incident of security, grossly inadequate if the premium should prove insufficient for the risk run, the property owner would not secure the indemnity he is paying for. The total capital of all the fire insurance companies, domestic and foreign, reporting to the New York Insurance Department at the close of 1898,

was less than ninety millions (\$89,476,981), while the amount of premiums held by them for their insurance in force was one hundred and two millions of dollars (\$102,872,081), whereas *the losses paid for the single year named were seventy-one millions (\$71,781,247), a sum, it will be observed, which was nearly seven-eighths of the total capital of all the companies engaged in the business.*

This simple but significant fact shows how important it is for the community at large that the average rate of premium of the companies should be high enough to pay the losses and expenses, and that it would not do to rely upon the capital invested as a security. State laws recognize this fact and require that whenever the reserves of a company are not equal to its liabilities so that its capital becomes impaired, the company must immediately make its capital good or retire from business.

COMPETITION IN FIRE INSURANCE.

Competition, which is claimed by some to be the life of trade, is the death of insurance if it results in inadequate prices or rates. The proper conduct of the business in the interest of all concerned involves accurately ascertained and equitable rates; a cheap price for insurance always implies reduced security, or the absence of that which it is intended to purchase, and inadequate rates must sooner or later result in worthless policies.

It should not require argument to demonstrate that, since all the companies having policies on a burned property must incur the same percentage of loss and also the same percentage of expense, they should get the same rate, and the property-owner may well be suspicious of a company offering to write at a lower rate than the majority of companies are willing to accept. The buyer of merchandise, who secures possession, when he acquires title, of an article of whose value he is a competent judge, may felicitate himself on a good bargain if he gets it below cost. With the merchandise in his possession and sure of its value, he has no reason to care whether the seller lost money on it or not, but it is not so

with insurance. Insurance is not a "good delivery" until the policy has expired or, in case of fire, until the loss has been collected; and he who secures it at a rate below cost and flatters himself that the other customers of the company do not secure the same terms, or overlooks the fact that, if they do, his insurance is likely to be worthless, would do well to keep his money in his pocket or deposit it in a savings bank.

If State legislatures would let insurance companies conduct their business without interference, in the same manner that they permit merchants to conduct their callings without legislative restrictions, the business would regulate itself; but if they undertake conscientiously to regulate insurance in the real interest of the community they should insist upon intelligent rating, which would carefully discriminate by higher charges for faults of construction, faults of management and negligence resulting in fires, and upon careful inspection and a conference to secure comparison of experience and the broadest basis for fixing prices. It should be borne in mind that the payment for a fire by an insurance company simply distributes the loss of the individual upon the entire community; it does not restore anything. Such drains upon the resources of the country must be felt in higher rates for insurance, higher taxation, and in financial depression. They are to a large extent preventable, and intelligent inspection and discriminating rating by insurance companies would secure this end.

Proper rates
in interest of
Public.

Where buildings are rated by a system which charges for defects in construction and faults of management, for negligence as to the care of ashes, rubbish and other faults which tend to cause fires, a charge being made for each fault, the result will inevitably be to correct such faults by the property-owner who will naturally wish to save the annual charge which would otherwise be a burden for the entire life of the structure; and those who erect new buildings would be led to construct them properly with a view to saving this expense. It is in this way that the business of insurance properly conducted by combination of companies to lessen the expense of

inspection and to secure correction, operates for the improvement of cities and the reduction of the fire waste more potentially than building laws. If companies, on the other hand, are compelled to perform this task each for itself, the expense will be increased to a point where they cannot profitably conduct the business, moreover in the case of a property requiring the policies of twenty or more companies a single company could not secure correction, for it would require the co-operation and influence of all interested.

It may safely be asserted that the enormous fire waste of the country, costing at present at the rate of more than one hundred and twenty-five million dollars per annum, or more than ten millions a month, would be materially increased but for the inspections and suggestions of insurance companies, enforced by higher rates charged to those property-owners who are careless or indifferent as to fire; and would be materially decreased if legislative restrictions in various states did not prohibit the co-operation of insurance companies for so laudible a

Annual Fire
Waste.

purpose directly in the interests of the community.

It certainly requires no argument that the property-owner who is indifferent to safety or who builds insecurely should have to pay more for his insurance than one who observes every precaution. Sweeping conflagrations in cities are beyond the calculations of fire insurance companies and consume the savings of years. The Chicago fire alone required the savings for seventeen years of active business of those companies who paid in full, showing that at least five per cent. of the premium should be reserved annually in the surplus to meet these abnormal demands. Nor can underwriters rely upon the certainty that serious conflagrations may not follow each other at short intervals, as in the case of the Chicago and Boston conflagrations, which were only thirteen months apart.

It is due to the combined influence of companies in the preparation of accurate rating schedules that superior classes of buildings, calculated to form fire stops in compact cities, have been erected. It has improved the water supply of communities, and their fire departments. Without the influence of such discriminatory insurance rates there would be little or

no inducement for safe building or for proper attention to fire-extinguishing facilities. *Any system of insurance rating which does not discriminate between safe construction and unsafe construction and between carefulness and negligence is an injury to the community and a gross injustice to that better class of citizens who build securely and manage their affairs prudently.* The information necessary to point out faults of construction and management is alone possessed by the insurance companies, acquired as it has been by them in investigating and paying for fires through a long series of years. It would be as shortsighted to compel companies to write at inadequate rates as it would be to require savings banks to pay six per cent. interest and invest their deposits at three per cent.

CORPORATIONS BENEFICIAL.

Animosity towards corporations grows largely out of misapprehension in regard to them. The individual citizen does not and should not lose his rights by becoming a member of a corporation any more than by becoming a member of a partnership firm. It is in the power of any citizen to become a shareholder, even though his means are limited. \$100 will buy a share in a new insurance company. He is thus enabled to engage in a business which he may not understand and to secure intelligent management and expert knowledge which he does not himself possess.

Corporations enable people of small means, by joining forces and uniting their savings to secure the same advantages for business purposes that millionaire capitalists enjoy ; and a corporation thus becomes a poor man's opportunity. Were it not for corporations millionaires would enjoy a monopoly of all large enterprises and would have things their own way. Among the stockholders of insurance companies, thousands in number, are widows and orphans, who are thus enabled to keep their modest capital employed and to have an active partnership in commercial undertakings.

THE EXPENSE OF THE INSURANCE BUSINESS.

It is, perhaps, not unnatural that property-owners, having in mind only the simple process of writing a policy of insurance by an agent of an insurance company and the delivery of it by him to the assured or property-owner, should regard the expense of transacting the business as merely nominal. They overlook the fact that a greater number of persons of various qualifications must be employed and remunerated before the policy of insurance can be written and delivered by the agent, and that the percentage of the premium required to pay the expenses of the business (about 35 per cent.) is not greater than that involved in the sale of merchandise, a piece of calico, for example, which includes the profit to the planter who raises the cotton; to the compress that presses it; to the commission merchant who sells it; to the common carrier that carries it to the mill; to the mill owner who manufactures it into cloth, including his operatives; to the dye and print establishment that prints it; to the commission merchant in the distributing centre of a great city who sells it; to the wholesale merchant, who, in turn sells to the retailer, who in turn delivers it to the consumer. All of these processes involve separate remunerations and an aggregate percentage of expense fully equal to that of the insurance business, which requires the agent in the town, who writes and delivers the policy of insurance; the expert who inspects the building from time to time during the term of the policy; the rating expert who fixes the rate, recognizing every point of construction, occupancy and environment; the adjuster who must adjust the losses; the accountants and book-keepers in the offices of the company, and, lastly, the executive officers, who must employ all of these men, supervise their work, and attend to the investment of the assets and reserves of the company, not forgetting office rent, stationery, blank books, printing, postage, and last, but not least, taxes—the latter seldom less than two and a half per cent. of the premium, to be paid whether the company makes money or not. So that it is doubtful if any business involves greater necessary outlay or requires higher

executive ability or a broader education as to the methods and hazards of all other occupations.

The expenses of the insurance business will be found to be not far from 35 per cent. Of this sum about one-half, $17\frac{1}{2}$ per cent., would be required for the compensation of the local agents in the cities and towns throughout the country, out of which they have to pay their office rent, and the cost of conveyances for visiting risks to inspect them, some of which would be located in the country on farms, for example. This percentage on the average premiums often amounts after a hard day's labor, in the average town, to little more than the wages of a skilled mechanic. To secure this commission the agent must inspect each building carefully, write and deliver the policy, collect the premium and remit it to the company and report all the facts of the risk to the principal office, maintaining supervision of it throughout the life of the policy in the interest of his company, to detect and report any change or increase in the hazard.

In addition to this percentage paid to the agents, 5 per cent. of the premium would be required for adjusters and special agents, traveling experts and their hotel and other traveling expenses, for supervising the business, going from agency to agency.

In this connection it may be well to state that money expended for inspecting buildings, calling the attention of ignorant or careless property-holders to faults of management or negligence, to faults of construction, etc., etc., all tending to prevent fires, and especially to prevent large or sweeping conflagrations, is money actually expended in the interest of the public or insuring property-owners.

Ten per cent. would be necessary to pay the official staff at the principal office, clerks, book-keepers, rent, advertising, postage, expressage, printing, stationery, blank books, etc., etc.

Two and a half per cent. would be required for taxes. At present a larger sum is necessary on account of the war tax. In this connection it will probably surprise those engaged in other lines of business to learn that insurance companies are taxed, not upon the profit of their business, but upon their

premiums, which is equivalent to taxing a merchant $2\frac{1}{2}$ per cent. on his sales. It sometimes results that in a state in which the business has been unprofitable the company actually pays a tax for the privilege of leaving more money in the state than it takes out of it, and so for the privilege of making a loss.

There have been years when the insurance companies paid taxes amounting to millions of dollars *when their total business showed a loss.*

| | | | | |
|---------|---------------------|--------------|------------------------|--------------|
| In 1889 | there was a loss of | 5,369,983 | when a tax was paid of | 2,368,360 |
| 1891 | " " " | 9,218,797 | " " " | 2,596,902 |
| 1892 | " " " | 6,377,489 | " " " | 2,727,974 |
| 1893 | " " " | 10,410,102 | " " " | 2,961,571 |
| 1898 | " " " | 1,919,650 | " " " | 3,900,134 |
| | | \$33,296,021 | | \$14,554,941 |

The ratio of taxes paid to net gain (*i. e.*, excess of premiums over losses and expenses) for the remaining years of the decade, viz.: 1888, 1890, 1894, 1895, 1896, and 1897 were as follows:

| Year. | No. of Cos. | Ratio of Taxes to Net Gain. |
|-------|-------------|-----------------------------|
| 1888 | 152 | 323.69 |
| 1890 | 148 | 88.49 |
| 1894 | 121 | 28.31 |
| 1895 | 121 | 33.11 |
| 1896 | 134 | 25.38 |
| 1897 | 152 | 36.45 |

Can any other business show such a burden of taxation?

Charles Sumner, when United States Senator, wisely said "a tax upon insurance is a tax upon a tax and, therefore, a barbarism." As the insurance company must collect enough from property owners to pay its losses and expenses and yield a living profit, it is clear that the citizens of a state, after all, have to pay the tax, with the expense of collecting it added—which is a farce. A tax upon the profits, on the other hand, is a tax upon the insurance company and one that it should pay without complaining. A tax upon the premium is a tax upon the assured property-owner and one he ought not

to pay. No insurance company would complain of being taxed $2\frac{1}{2}$ per cent. on that portion of the premiums received in a state after deducting the losses and expenses, paid to its citizens, and this should be the basis of taxation everywhere. The rate of tax should be the same as that imposed by the state on personal property in the state, and beyond this there should be no tax—either state, county or municipal.

In his annual report for 1898, Superintendent Matthews, of the State of Ohio, says.

"Seventeen of the companies doing business in Ohio last year paid out for losses more than they received in premiums." * * * "They not only did not have any of the premiums in their possession at the close of the year, but paid back to the people an additional sum of \$115,397.31. Upon what principle of equity is based this law of requiring gross premiums to be taxed I am unable to understand. It seems to me that fair dealing would require net premiums only to be taxed, or that which is left after payment of losses, commissions and return premiums."

And he adds:

"These startling figures answer the question probably so frequently asked, why have we not more good fire insurance companies in Ohio? It would seem that the profits in the business do not justify the risk of investment, and surplus capital seeks employment in other enterprises."

THE PERCENTAGE OF LOSS.

This may be expected to be 55 per cent. of the premium. The largest and most successful companies have experienced not less than this percentage of loss as the result of the years they have been in business. If to this percentage be added the thirty-five for expenses, there will be left ten per cent.—five of which should be accumulated, as already stated, for sweeping conflagrations, and the remaining five per cent. will probably not be regarded, by those engaged in any other business as an abnormally high profit, leaving out of consideration the great risk run by those whose capital is invested. Would any tradesman, merchant or manufacturer regard 5 per cent. on his sales as an undue profit, especially in a business where the single transactions are as small as those of insurance?

VALUED POLICY LAWS.

No legislation more inimical to the interests of the community or injurious to the business of fire insurance has been

enacted of late years than so-called "Valued Policy Laws," which require, in the event of the destruction of a building, that its owner shall receive the full amount for which he has effected insurance upon it, even though it be more than the actual cash value of the property destroyed. As already stated, an insurance policy is not an undertaking to pay a stipulated sum in the event of loss, but a contract of indemnity or protection, so that when a property-owner pays, say, \$50 for a \$5,000 insurance policy, he is paying \$50 for \$5,000 worth of protection against loss by fire for a given time—the term of the policy, one year, three years, or five years. If during that period a loss occurs he will receive the amount of the loss, not exceeding the amount named as the limit of insurance. He may have five or more partial losses on the same property during the time for which the policy is written and receive pay for each of them and still not exhaust the whole amount of protection, unless the aggregate sums paid equal the amount of limit in the policy.

The standard, legal form of an insurance policy contracts to insure the property-owner in the following words:

"Against all direct loss or damage by fire to an amount not exceeding five thousand dollars."

Overlooking these unmistakable terms, some property-owners and legislators infer that the agreement is to pay five thousand dollars in the event of the destruction of the property, though it might not be worth more than one thousand dollars. They also overlook the fact that the policy may be written for one year or, as is often the case, for five years, and that the value of the building, by age, use, decay, &c., may be much less at the end of the term than at its beginning. A "valued policy" law would in such case work most unjustly.

What would be thought of a law compelling the surety on a fidelity or indemnity bond to pay the face of the bond, without regard to the amount of shortage or damage? And yet such a law would be exactly in line with a valued policy law requiring a company to pay the face of the policy when the actual loss or damage might not be ten per cent. of the amount.

Those advocating such laws argue that insurance companies should investigate the values of the properties they insure if they do not wish to pay the full amount of the insurance, and that it will be their own fault if they are mulcted an undue amount. This argument overlooks the fact that to properly ascertain the actual cash value of a building requires a careful examination by expert builders, masons, carpenters, etc., who would charge for their services in many cases—especially in the case of buildings of small value—those of the poorer classes and particularly farm buildings in the country, which they would charge extra to visit—as much as, or more than, the whole premium paid for the insurance. Such expensive expert examinations ought to be necessary only in case of a fire to ascertain the amount of loss, and, therefore, only in the one case of a burned property out of the hundreds which do not burn. A “Valued Policy” law, thus works most oppressively upon the property-owners of small holdings and least oppressively on the properties of larger value, whose owners do not, as a rule, seek an undue amount of insurance, and the requirement entails that the same labor and expense, shall be incurred as to each of hundreds of risks to prevent the single property-owner who may have a loss from collecting more than he is entitled to receive.

Why should hundreds of property-owners be subjected to the expense of higher rates of insurance, made necessary by the expense of ascertaining the actual cash value of their own property, as well as that of the one who has a fire, when that one needs no expert investigation to ascertain his value?

The man who insures his building knows better than anyone else what it is worth; he is not obliged to pay for more insurance than would protect him for its full value. If he does, it is safe to assume he contemplates a fraud upon the insurance company and should not be assisted in consummating it by the operation of law on the plea that he ought to receive the full amount of the limit named in the policy simply because he voluntarily and knowingly paid for more than he knew was necessary to protect him

against actual loss. A valued policy law is in reality a premium upon fraud and an incentive to incendiarism or burning for gain, imposing unnecessary burdens upon honest citizens, who must be taxed in higher rates of premium to pay for the exaggerated claims of an unprincipled few.

Further, the argument in favor of valued policy laws also overlooks the obvious fact that an honest claimant is sure to receive the full amount of his loss in any event, since no intelligently managed insurance company would be so shortsighted as to refuse to pay an honest claim, realizing that, in case it should, it would be forced to do so at law, for courts and juries never

sympathize with corporations, but always with the individual. Moreover, all insurance policies contain a clause which provides that in case of differences between the owner and the insurance company the matter in dispute shall be left to disinterested appraisers, chosen by each, who, in turn, shall select a third as umpire. A man is thus entitled to have for his appraiser any neighbor in whom he trusts. It would with this provision be impossible for an insurance company under its policy to escape paying all to which any claimant is entitled. Insurance companies are not litigious; they cannot afford to go into courts except with clean hands and with claims of unmistakable justice. The statements of the companies reporting to the New York Insurance Department show that a sum less than two per cent. of the amount of losses paid by them during the past year was in suit at its close, and as those losses in suit were the result of an average of at least three years' business, it follows that *the claims contested by companies are less than one per cent. of the whole amount of the losses incurred.* When it is remembered how many fraudulent claims are made upon insurance companies, it becomes a serious question, not whether too many claims are contested by them, but whether enough are resisted to protect the interests and insure the security of their more honest claimants.

There is no need of "valued policy" laws. They simply entail an unnecessary expense upon ninety-nine men who do not burn in order that one man, presumably a dishonest claimant, may

receive more than he is entitled to. The increased expense of transacting the business, with the care made necessary by a valued policy law, must inevitably raise the rates of premium and cost of insurance, so that such laws from every viewpoint are shortsighted and directly against the interests of all honest property-owners who should use their influence and arguments to induce their representatives in the State legislatures to repeal them wherever they are in force and to oppose them whenever introduced.

Probably no stronger argument, certainly it would be difficult to find a more clearly expressed one, could be offered against valued policy laws than that in the report of the Hon. W. S. Matthews, Superintendent of Insurance of the State of Ohio, for the current year. He says :

“The Ohio valued policy law, Section 3643, provides that, in the event of total destruction of property insured, the amount of insurance, and not the value of the property insured, should be the measure of the loss, and the amount the company shall be obliged to pay. This law was passed in 1879, presumably for the purpose of protecting the people against what was supposed to be unfair adjustment of losses. The theory no doubt in the minds of those responsible for this legislation was that the companies were to blame for the amount of insurance written in the policies, and, having collected the premium, the assured was entitled, in the event of loss, to all the insurance he had paid for. This reasoning is all right when applied to the purchase of property, but it is not correct when applied to the purchase of insurance on property. One is a contract for the exchange of equivalents, while the other is the purchase of an agreement to indemnify, or to make good a loss if a loss occurs. The nature of the two contracts is entirely different. A fire insurance contract is not a contract to pay unconditionally the sum named in the policy unless the loss sustained is equal to that sum. The sum named in the policy is simply the measurement of the company's maximum liability. The objection to a valued policy law is that it ignores the fundamental principle of insurance, which is that of indemnity pure and simple, and compels the company to pay the full amount named in the policy although the actual loss may be but one-half or two-thirds that amount. To put this construction upon the obligation of the insurance contract is to convert the whole scheme of insurance into a money-making and gambling transaction. It is a statute that may make it more profitable to destroy property than to keep it. It is a statute that places before every evil disposed person the temptation to over-insure and then burn his property for the gain there is in it. And even where the assured is honest, he is liable to be made more indifferent as to the care he should take of his property by over-insurance. Every property-owner should at least carry some of the risk which attaches to property. It is not a statute in the interest of honest policy-holders, but only in the interest of the dishonest man who wants to speculate off of insurance. The honest policy-holders of the State, therefore, lose in two ways on account of this law. First, because of the increased rate of insurance on account of the increased moral hazard superinduced by the valued policy law.

And, second, because of the increased fire exposure on account of the incentive to burn or to be careless of excessively insured property. It is very evident that if valued policy laws increase the fire loss, they must necessarily increase rates of insurance, for rates increase or decrease in proportion to the increase or decrease of fire loss. The only protection a company has against adverse conditions, whether in legislation or society, is the adjustment of rates. The extra loss to companies on account of the valued policy law is certainly shifted from them on to the honest policy-holders of the State. *The policy-holders, therefore, are the ones to pay these extra losses, and instead of this law being a benefit to them it is an expensive and costly experiment.* If the rates for fire insurance are lower in Philadelphia than Chicago, or in Boston than in St. Louis, it is because the fire loss to amount at risk is continuously lower in Philadelphia and Boston than in the other places. If they are lower in one State than in another, or in one section of the country than in another section, it is because the general conditions existing in one State or section are more favorable to fire losses than in the other. Any condition, therefore, such as moral hazard, poor buildings, poor fire protection, or valued policy laws, that tend to increase the expenditures of companies necessarily increases rates and makes insurance more costly and burdensome to the general public."

"I can conceive of nothing that the State, in its legislative capacity, can do, more dangerous to the prosperity of the State, and to public morals, than to pass a law that invites wilful and malicious destruction of property, or encourages carelessness in the care of property. In legislating upon the subject of insurance, the great and paramount concern of the State should be to eliminate every feature of speculation and gain from the transaction."

And he suggests, with great force:

"Suppose the State itself should undertake the business of insuring the property of the people, is it to be supposed that it would enact a valued policy law?" If the State should undertake such business, I predict the first step taken would be to reenact an entire new code of insurance laws, and in this new code the State would throw out every unjust restriction upon the freedom of contracts, eliminate the valued policy law, limit the amount of insurance to be carried probably to the assessed value of the property, establish a uniform tariff of rates, and make provision for thorough investigation into the cause and origin of all fires, and provide that in no case where a loss has been sustained shall there be paid a greater amount than the loss incurred at the time of the fire. *If the State undertaking to do the business of insurance would adopt such provisions of law as a matter of safety and justice to itself, why should it not do so with respect to companies or corporations?"*

Could a more forceful argument be made against a valued policy law, and could it emanate from a more reliable authority than the insurance official of a great State in which such a law has been in force since 1879, and in which seventeen companies paid to the citizens of the State in losses and expenses one hundred and fifteen thousand dollars more than they collected, after paying a tax for this privilege of two and one-half

per cent. on the gross premiums, which amounted to nearly five thousand dollars? No wonder Superintendent Matthews, in commenting upon the business in Ohio, says :

“The general condition of the business of fire insurance in Ohio for 1898 was anything but satisfactory or profitable.”

IMPORTANCE OF INSURANCE.

Few persons realize to what importance insurance has grown as a factor in the commercial world. It is to-day the security on which most enterprises rest, without which their projectors would hesitate to engage in them. The lender could not afford to trust the borrower if the ability of the latter to pay the debt was liable to be cancelled by a fire. The last census report showed that the real estate mortgage loans of the United States amounted to more than six thousand million dollars (\$6,019,679,985.) Of this enormous sum the citizens of Illinois alone had borrowed three hundred and eighty-four millions; Massachusetts three hundred and twenty-three millions; New York sixteen hundred and seven millions; Pennsylvania six hundred and thirteen millions. It is safe to say that all of these loans are based upon insurance policies held as collateral security. Can anyone estimate the consequences if these mortgages should be called in by the lenders, deprived of their insurance collateral and unwilling to trust their money to the contingencies of fire! Can anyone doubt that such action would be taken if fire insurance capital should be withdrawn from a business made unprofitable by the burdens which mistaken legislation is increasing year by year!

There is probably to-day not an enterprise in the business world which does not depend upon the security of Fire Insurance. It protects alike the dwelling of the laborer and the palace of the millionaire; the business of the retail dealer and the aggregated values of the largest manufacturers. Without the assurance which its protection affords it is doubtful if the enterprise of those possessing capital would be exerted sufficiently to give employment to the wage-earner or to keep the

wheels of trade and manufacture in motion. Commerce would be paralyzed, for credit would be withheld where confidence would be wanting in the ability of the purchaser to pay. It is the handmaid of commerce and the guardian of industry. Ventures are made without hesitation which would appall those embarking in them if liable to miscarry through a single fire; large values are boldly collected to meet the requirements of commerce where an accidental conflagration might destroy them in a night; merchants sell their goods on extended credits knowing that although the misfortune of fire may overtake the purchaser his insurance indemnity will enable him to pay for them not less readily than before; vast industries giving employment to thousands of operatives and supporting whole towns by their enterprise, testify not more to the courage of their projectors than to the confidence they repose in the protection which insurance gives to their undertakings; and, to-day, insurance is as certainly a necessity of commerce and manufacture as is the railroad or telegraph or steam power itself; it is as essential to the commercial system of the world as the woof thread to the fabric of the loom.

Probably no more eloquent tribute to the spirit of insurance is to be found than the utterance of the French jurists, at the close of their report to the council of state, on the subject in the code of commerce:

“Insurance may justly be deemed one of the noblest creations of human genius. From a lofty height it surveys and protects the commerce of the world. It scans the heavens; it consults the seasons; it interrogates the ocean, and, regardless of its terrors or caprice, defines its perils and circumscribes its storms. It extends its cares to every part of the habitable globe, studies the usage of every nation, explores every coast, and sounds every harbor.

“To the science of politics it directs a sleepless attention; it enters the council of monarchs, watches the deliberation of statesmen, weighs their motives and penetrates their designs. Founding on these vast materials its skillful calculations, secure of the result, it then addresses the hesitating merchant: ‘Dismiss your anxiety and fear; there are misfortunes that humanity may deplore but cannot prevent or alleviate. Such are not the disasters you dread to encounter. Trust in me,

and they shall not reach you. Summon all your resources, put forth all your skill, and with unfaltering courage pursue your adventures. Succeed, and your riches are enlarged ; fail, and they shall not be diminished. My wealth shall supply your loss. Rely on me, and for your sake, at my bidding, the arm of your enemies shall be paralyzed, and the dangers of the ocean or the flaming pile cease to exist.' The merchant listens and obeys, and is rewarded. Thousands, tempted by his success, follow his example. Those whom it had long separated, the ocean now unites. The quarters of the world approach each other and are bound by the permanent ties of mutual interest and mutual benefit."

ARE COMBINATIONS OF UNDERWRITERS INIMICAL TO THE INTERESTS OF PROPERTY-HOLDERS ?

We trust we have explained the relation of insurance to the community in such manner as to secure a negative to this important question. We trust we have established as facts :

FIRST—That Fire Insurance is a commercial and community necessity.

SECOND—That a policy of fire insurance is a contract of indemnity ; and

THIRD—That the reliability of the indemnity depends upon the sufficiency of the rate of premium, because

1. State laws properly require that if the capital is impaired it must be made good, or the company must cease doing business. If companies cannot pay their losses and expenses and secure a fair profit return on the capital adventured they will neither be organized nor continue in business if already organized ; therefore, capital is only an incident of the business and an adequate rate is indispensable. Insurance capital must and should have a fair return for the risk run—a law of community.

2. Adequate and equitable rates are necessary for the protection of the policy-holder as well as for the protection of the stock-holder. Otherwise the burden of insurance will be unequally distributed and one man's property will be protected, if insured below a proper rate, at the expense of another.

3. As inspection and supervision necessary for the ascertainment of correct rates can be as cheaply performed for one hundred companies insuring a single building or risk as for any one of them, co-operation is advisable to reduce the expense percentage. At the same time it would reduce the loss percentage by securing correction of faults which would cause fires and by encouraging proper construction which would tend to prevent their spread, and so result in cheaper insurance to property-owners. In this view, co-operation of insurance companies is directly in the interest of the community and should be encouraged and not prohibited. Laws which prevent companies from co-operating in this way, and compel each company to inspect each building for itself, must increase the expenses of transacting the business and result in unnecessarily higher rates of premium.

4. As the labor required to ascertain and fix proper and equitable rates for a building and its contents can be performed by the same expert in the same time for one hundred companies who insure it as for any one of them, co-operation to ascertain and fix rates would result in a saving of this expense also, and so further cheapen the cost of insurance to the property-owner and be directly in the interest of the public.

5. As rates of insurance are based upon the experience of the companies through terms of years on the various classes of hazards, most of which are so few in number that there would not be enough of a class in a single state or on the books of a single company to determine the experience cost of insuring them, the statistics of experience should be collated from the whole country, in justice to the owners of such risks, and not based upon the abnormal loss rate of a small class in a single state, which would indicate the necessity for an exorbitant rate on the class in such state, when in fact it might not be necessary.

6. The burden of insurance rates should be graded according to the percentage of insurance carried to value, just as municipal and state taxes are based upon uniform assessments of the same percentage of value; and *the property-owner who insures*

a proper percentage of his value is entitled to a lower rate than one who insures a small percentage, there being a difference between the cost of insuring different percentages of value even greater than the difference between that of wholesale and retail prices in mercantile business. Otherwise one class of citizens would be securing insurance at a lower cost than another and, therefore, at the expense of another. It should be borne in mind that insurance is in fact a tax, and the cost of the tax should be apportioned fairly or equalized among all contributing, not only according to faults of construction and other features that add to the hazard of fire, but according to the percentage of the value insured. If, as has been well said, "It would be the height of absurdity for a municipality to attempt to establish and collect a rate of taxation without an assessment of the value of each piece of property taxed, and no community would attempt such an absurdity," it would be an equal absurdity to charge those property owners who insure only a small percentage of their value at the same rate as those who insure a proper percentage and then base the rate charged to both on the percentage of the total losses to the total premiums, with the inevitable result of placing the burden unduly upon those who have contributed most liberally to the common loss and expense. Co-operation of companies, therefore, is necessary to provide for this in percentage co-insurance clauses in all policies.

It follows, therefore, since co-operation is necessary

To ascertain cost ;

To ascertain and secure adequate rates for indemnity ;

To prevent fires and thus cheapen the cost of insurance ;

To divide and lessen expense and so to further cheapen the cost of insurance ;

To secure that the same percentage of insurance should be carried by all owners or a difference in rate made—the principle of co-insurance or average which has always been a feature of marine insurance ;

That the conference of insurance companies and their co-operation must be in the interest not only of the companies themselves, but of their customers, the insuring public.

Co-operation in insurance is, therefore, not a "trust," in the modern and ordinary acceptation of the term, by which is meant a combination of those engaged in a particular business to extort improper prices from their fellow-members of the community and so to obtain an undue share of community benefit. There is not now and never has been, any "pooling" in the business of insurance. The ease with which any number of citizens can organize an insurance company will always prevent a monopoly of the business, and those engaged in it can always be relied upon, in their own interests, to regulate their prices with reference to this important fact. Exorbitant rates and abnormal profits always attract competition, which results in inadequate rates, and those engaged in the business thoroughly understand this. Managed on true underwriting lines, an insurance company is simply a great machine for distributing the burden of the fire loss of the individual citizen among his neighbors throughout the entire country, so that the burden of helping one who is unfortunate will be lightly felt by all. It is the truest and most sensible method of carrying out the scriptural injunction as to the distribution of burthens, and it is amenable to the laws of trade which automatically regulate the profits of all commercial enterprises so that no one class of citizens can long retain any undue advantage of their neighbors or any improper share of the community wealth.

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